

Diversify your Diversification

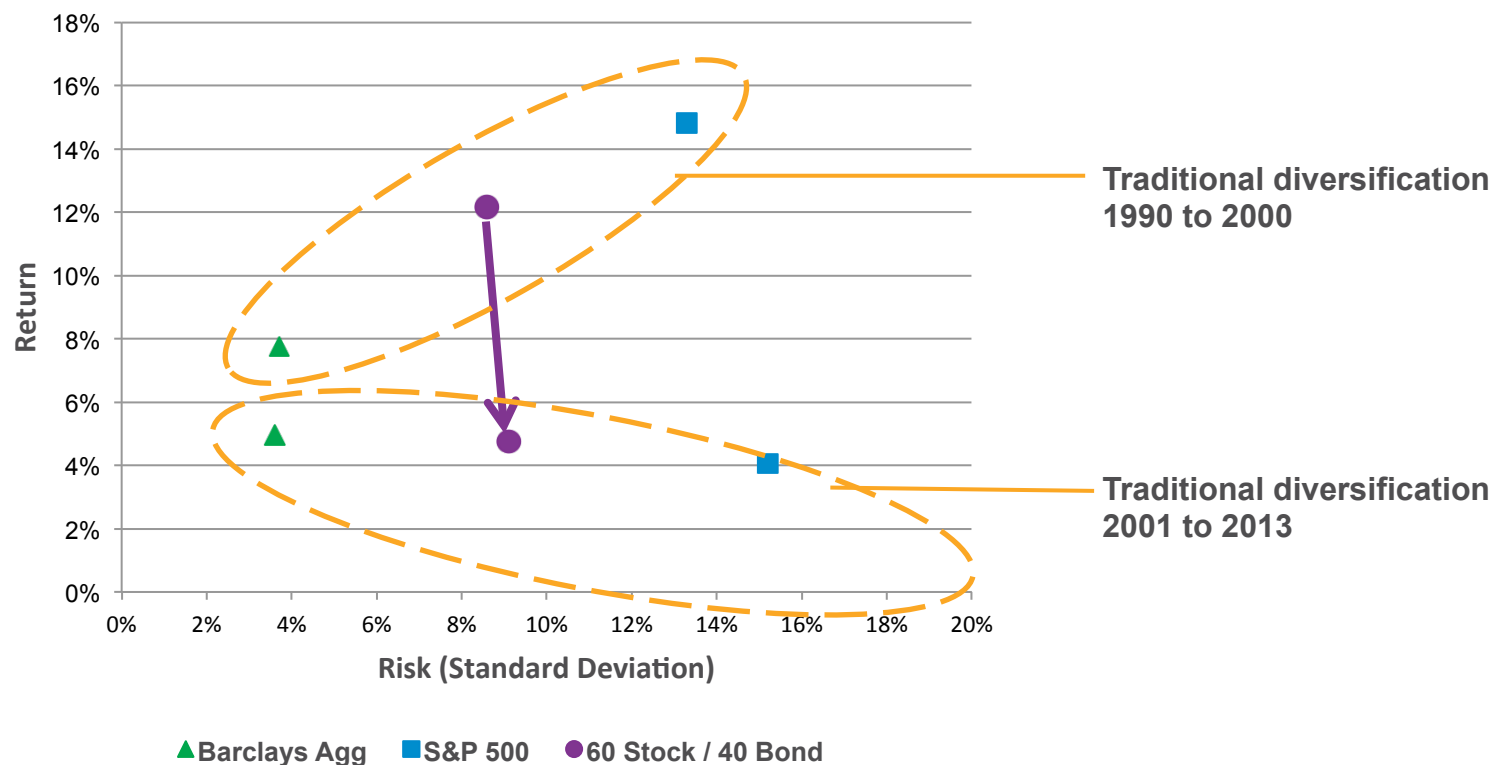
Ryan Manente
Vice President

May 2015

The Challenge to Traditional Diversification: The Return Environment has Changed

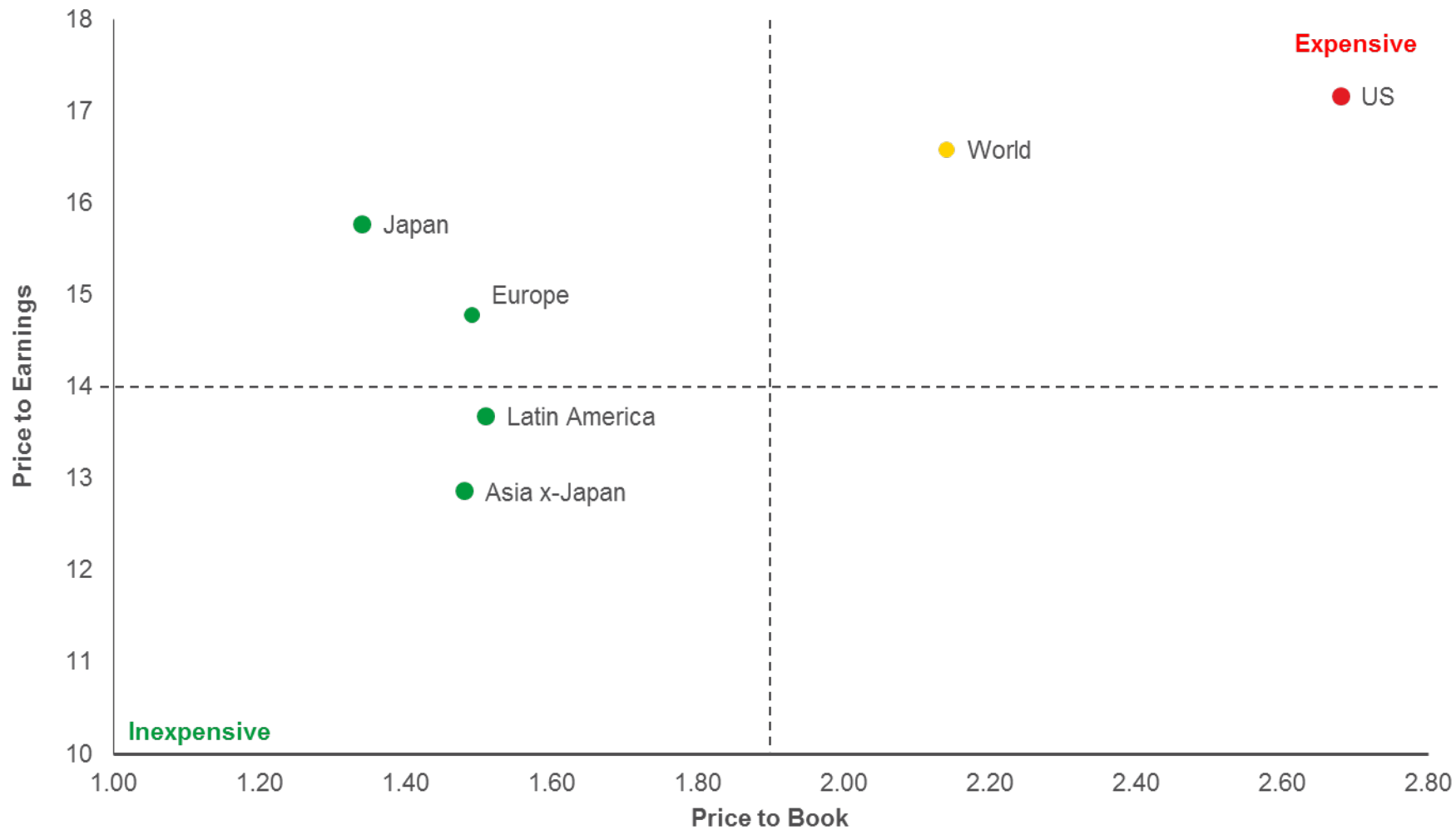
The past decade has ushered in a new cycle, and a traditionally diversified portfolio exhibited reduced return and increased volatility compared to the 1990s

In the last decade, a 60/40 portfolio's return fell dramatically while its risk (volatility) increased



Source: Bloomberg, Barclays Live. Equity is represented by the S&P 500 Index. Fixed Income is represented by the Barclays U.S. Aggregate Bond Index. 60/40 portfolio is represented by 60% S&P 500 Index and 40% Barclays U.S. Aggregate Index. Based on annualized returns, rebalanced quarterly. Past performance does not guarantee or indicate future results. It is not possible to invest directly in an index.

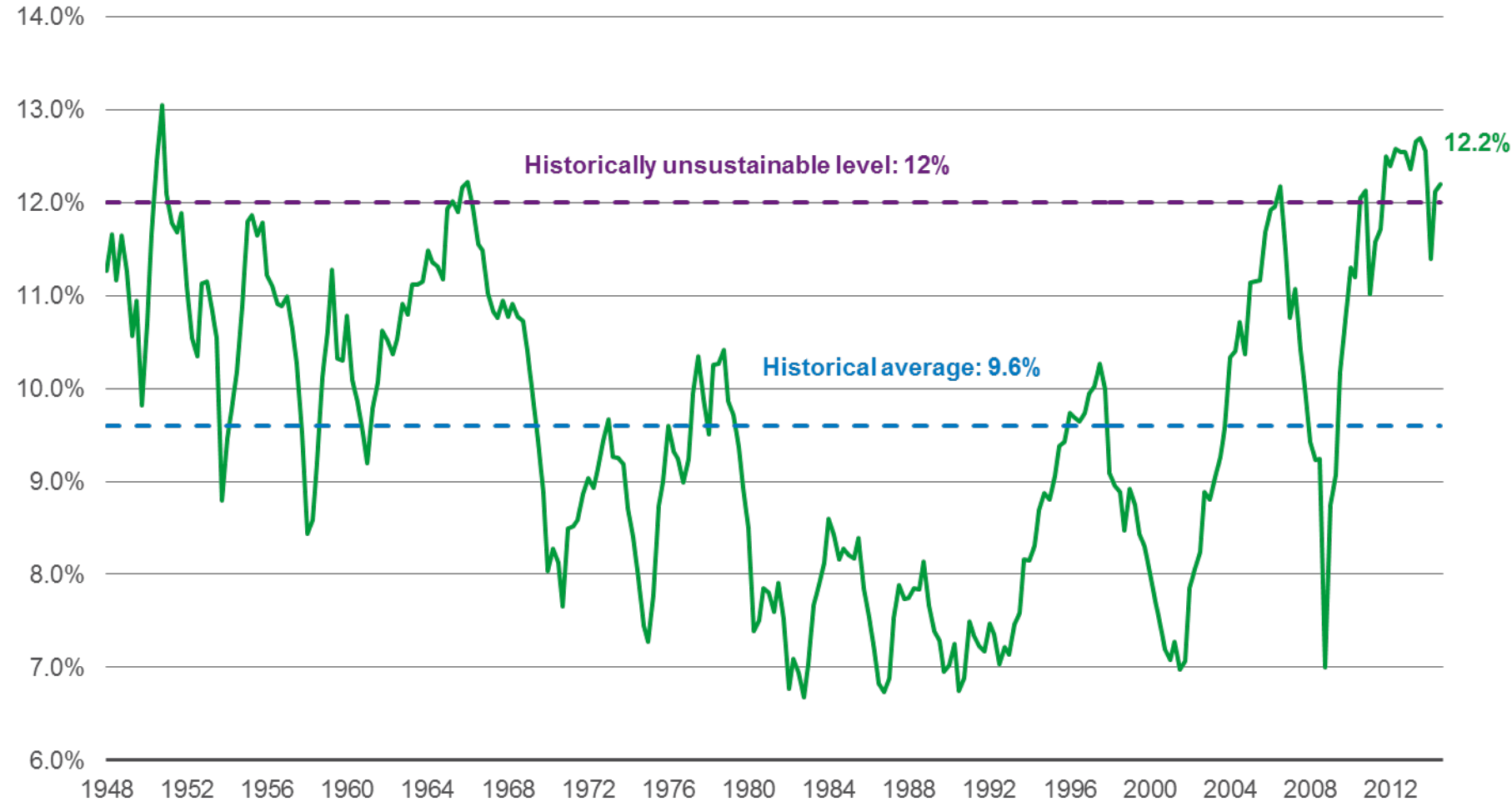
Equity Valuations Vary Greatly by Region



Source: Bloomberg, December 2014.

...and US Corporate Profits are Near Historical Highs

US corporate profits as % of GDP

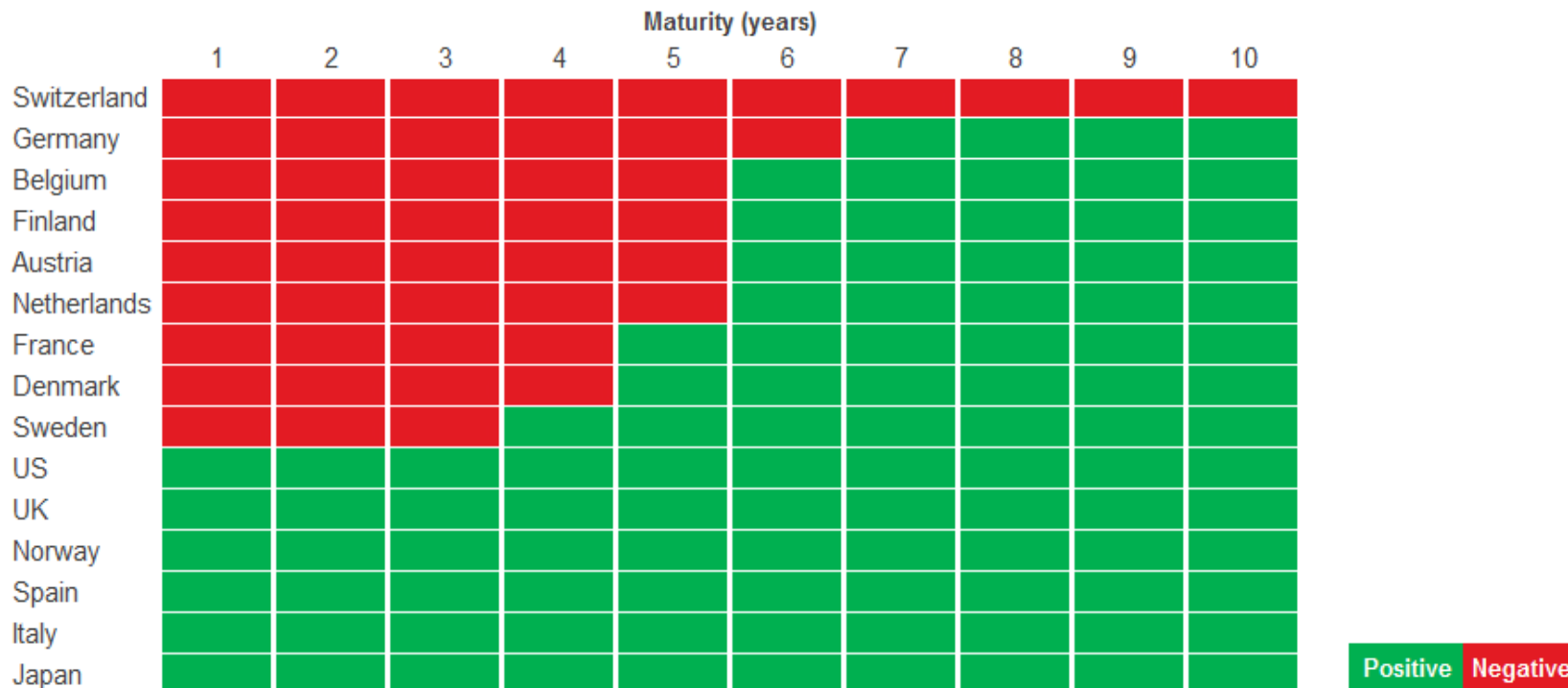


Source: US Bureau of Economic Analysis, September 2014.

Yields have fallen to record low levels

Disappearing yields

Negative Yields in Government Bond Markets

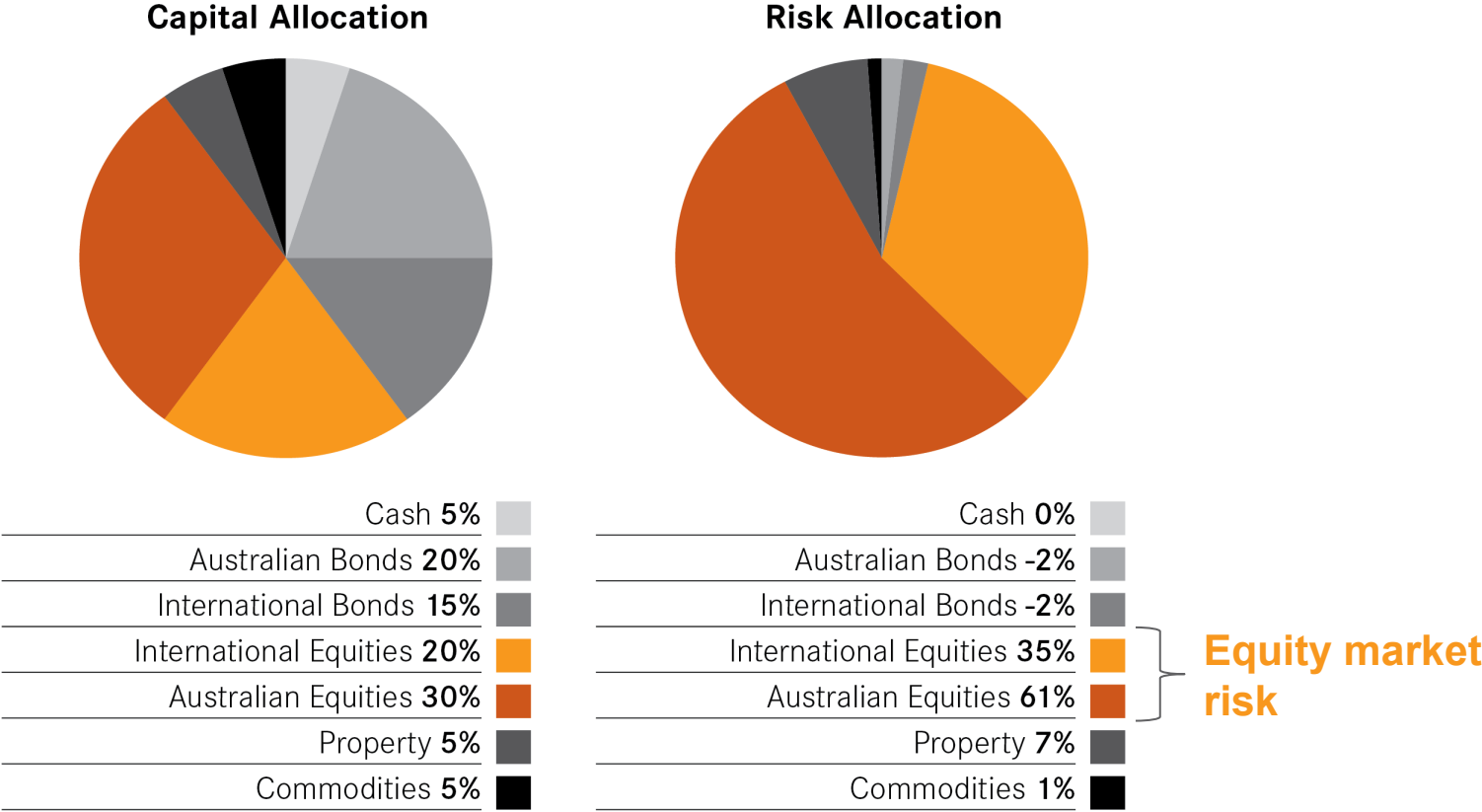


BlackRock Investment Institute, Thomson Reuters, March 2015

Redefining Diversification

Capital diversification does not equal risk diversification

Traditional 60/40 portfolio:



While capital allocations appear diversified, 96% of risk comes from equity exposures

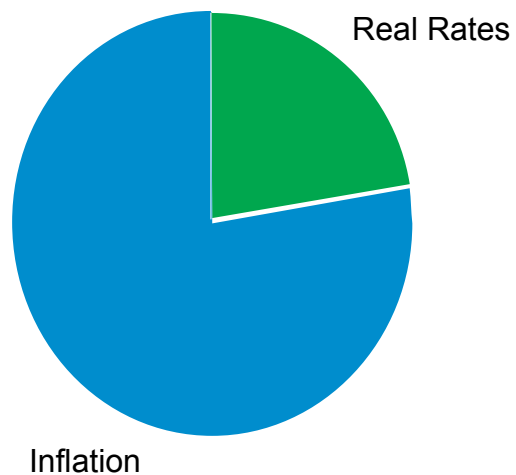
Source: BlackRock

Looking through a different lens

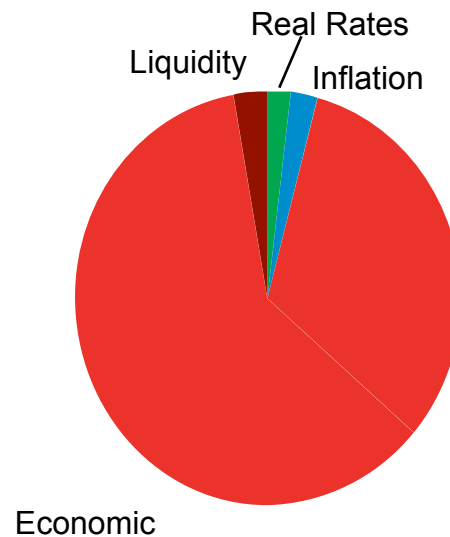
Asset classes can be viewed as merely a collection of different risk premia

- What are the real drivers of returns?
- Asset classes are simply a mixture of risk factors

Government Bonds



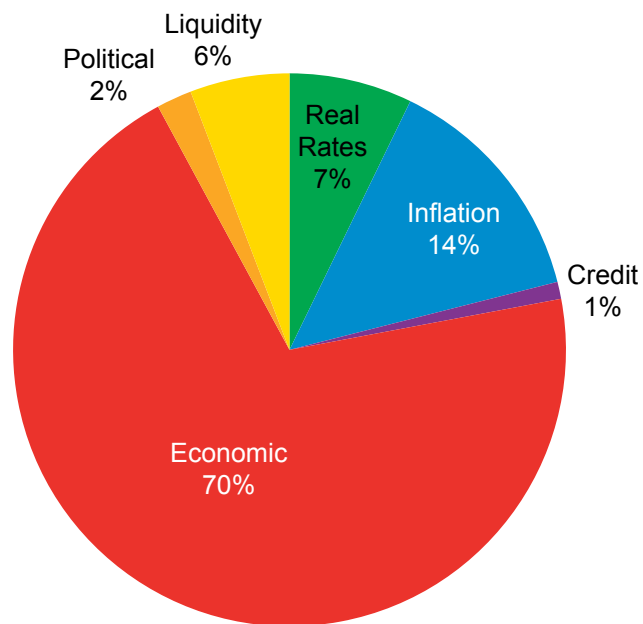
Developed Equities



Source: BlackRock

Using this framework, one factor dominates

Risk exposures of an average 'growth' portfolio:



Lesson:

- Portfolios are not adequately diversified; rely too much on economic growth to drive performance

Source: Pensions & Investments, BlackRock.
Average portfolio based on aggregate asset policy of Top 200 DB Plans as of September 30, 2012.

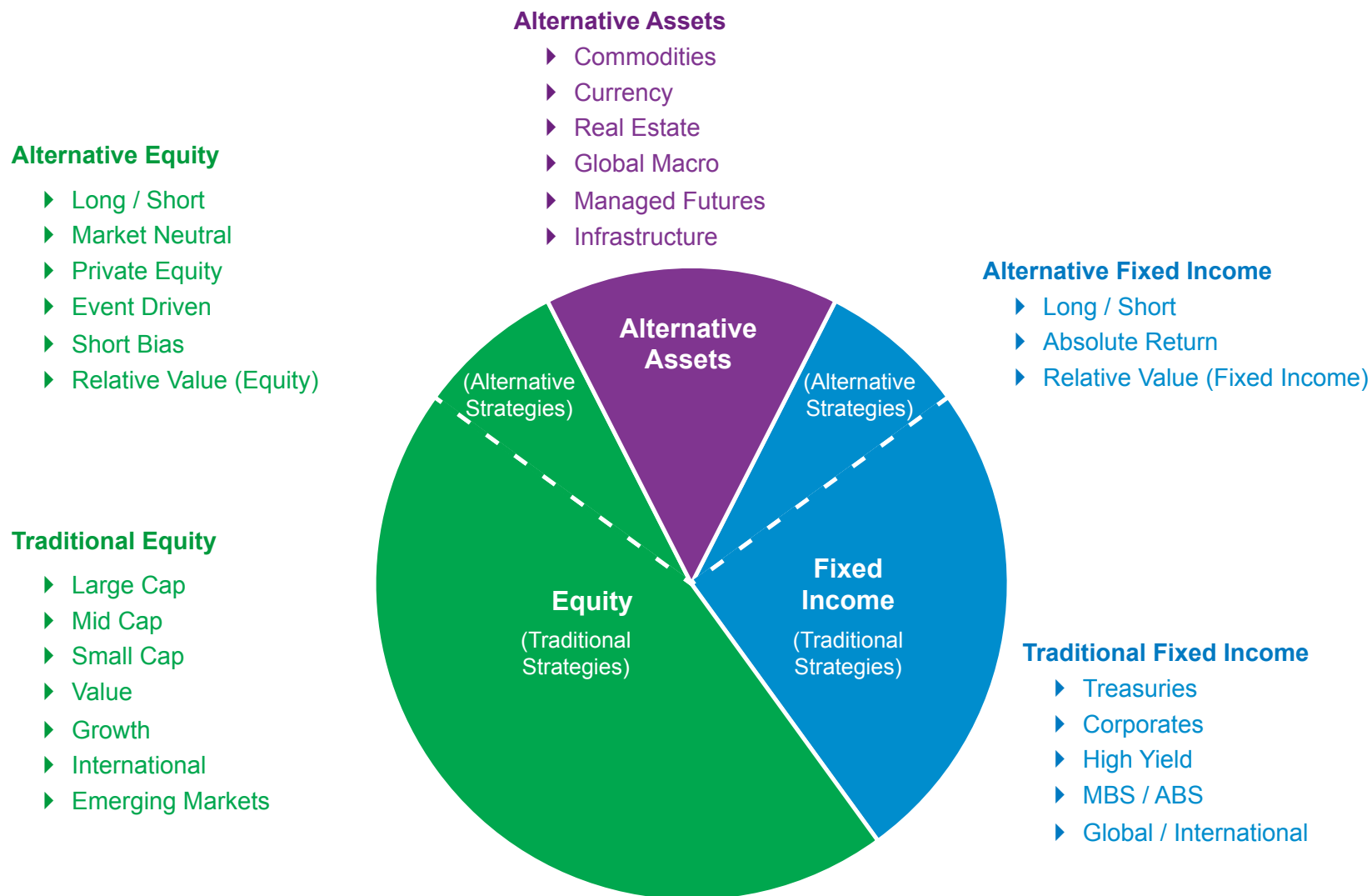
So what's the alternative...?

Allocating to Alternatives is nothing new

	Industry	Retail	Corporate	Public	APRA Funds	SMSFs	Super Total
Australian shares	29	26	30	22	26	32	29
International shares	25	22	28	27	25	0	17
Listed property	1	4	1	4	2	4	3
Unlisted property	10	2	7	6	7	15	10
Aust. fixed interest	6	15	14	7	9	1	6
Int. fixed interest	5	7	6	7	6	0	4
Cash and TDs	6	14	6	9	8	30	15
Other	19	9	8	18	16	16	16

Sources: APRA Annual Superannuation Bulletin default allocations multiplied up to allow calculation of Total; ATO SMSF database. The numbers are approximate only due to different description of assets. The main issues with SMSFs are allocating unlisted trusts (9%) and managed funds (4%) to 'Other'.

Need to Evolve Asset Allocation

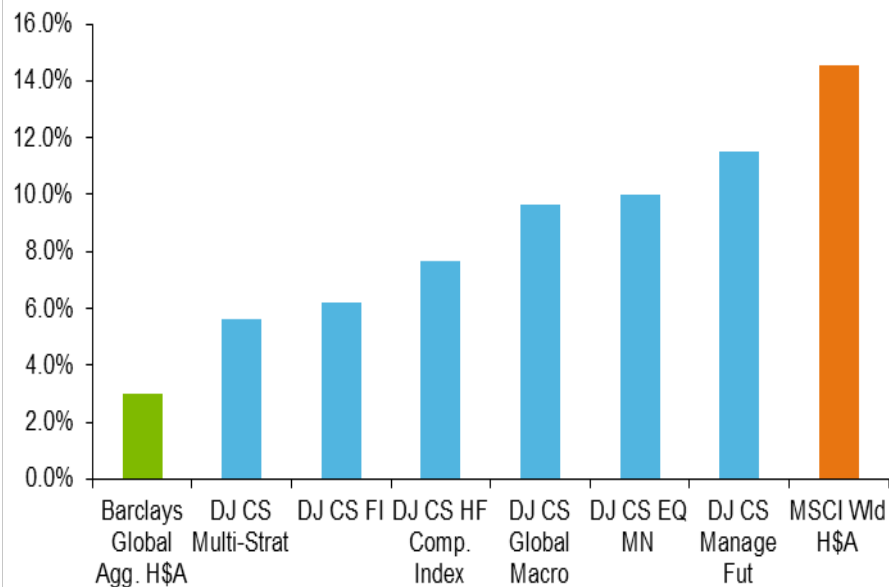


The chart above is for illustrative purposes only and does not seek to represent the asset allocation for all investors.

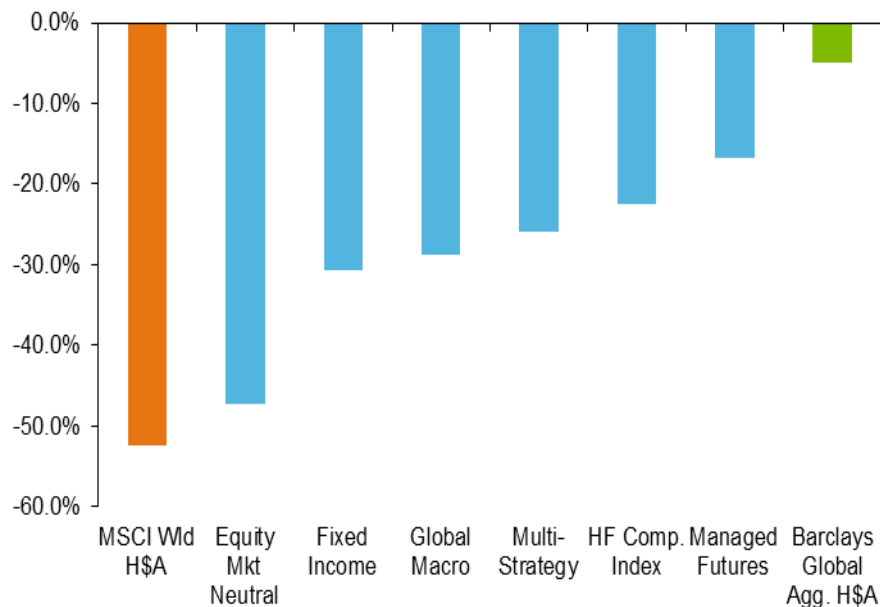
Hedge funds are risky, right?

- In 2011 APRA proposed a 45% capital charge for Insurance Companies Investing in HF's
- APRA's view is that HF's "have high risk and less liquidity than listed equities. In extreme circumstances, the realisable value of these types of assets may fall further than listed equities"

Annualised Risk (Jan 1994 - Mar 2014)



Maximum Drawdown (Jan 1994 - Mar 2014)



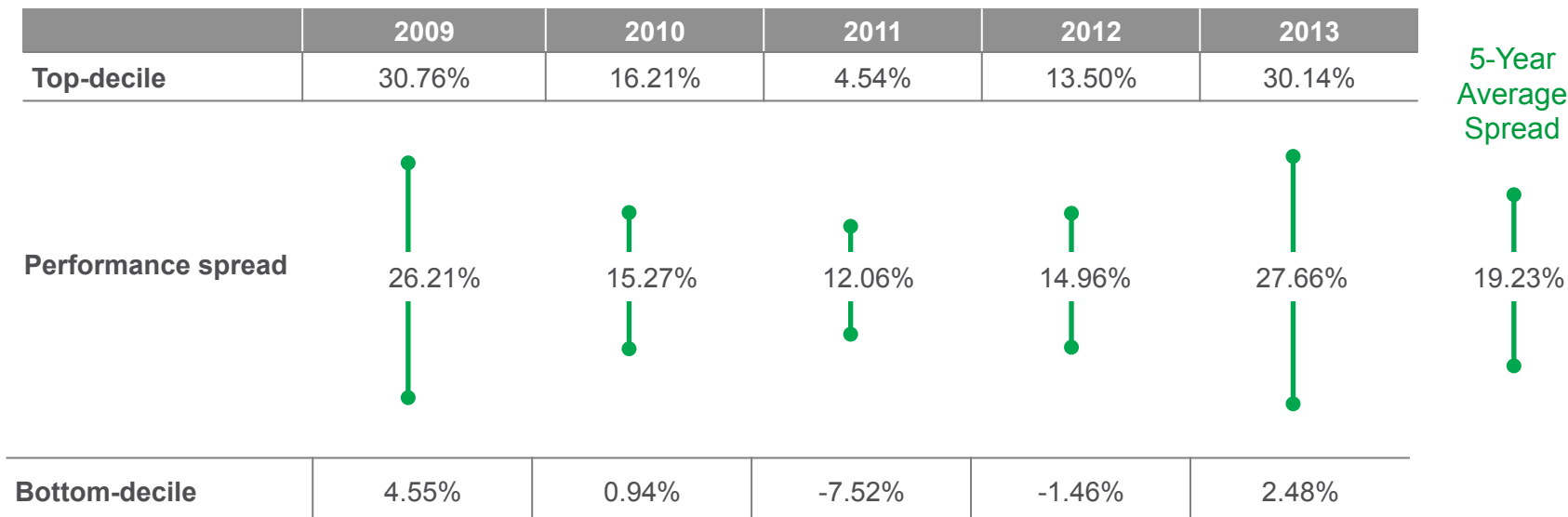
Source: Datastream, BlackRock

Manager skill is vital when selecting an Alternative strategy

- ▶ Alternatives are more driven by manager skill (alpha) vs. traditional asset classes / categories where market (beta) typically drives overall returns
- ▶ Over the last 5 years, the average performance difference between the top decile / bottom decile performers in the long/short category was 19.23% vs. 11.60% for a traditional category (large blend)

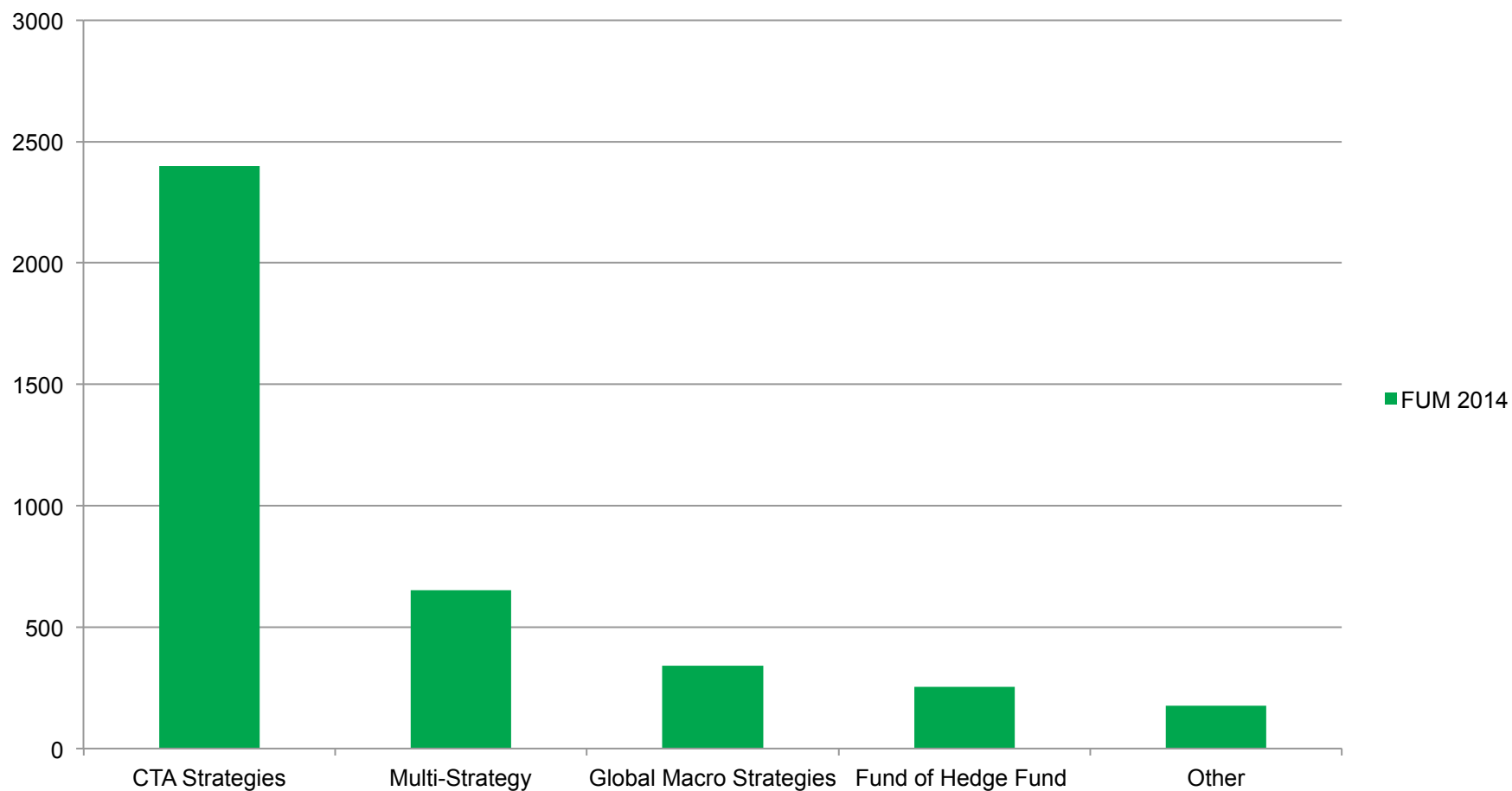
A huge gap between good and bad performance

Performance spread between top- and bottom-decile, Morningstar Long/Short Equity Funds



Source: Morningstar, as of 12/31/13. Performance is historical and does not guarantee future results.

Hedge Fund Strategies



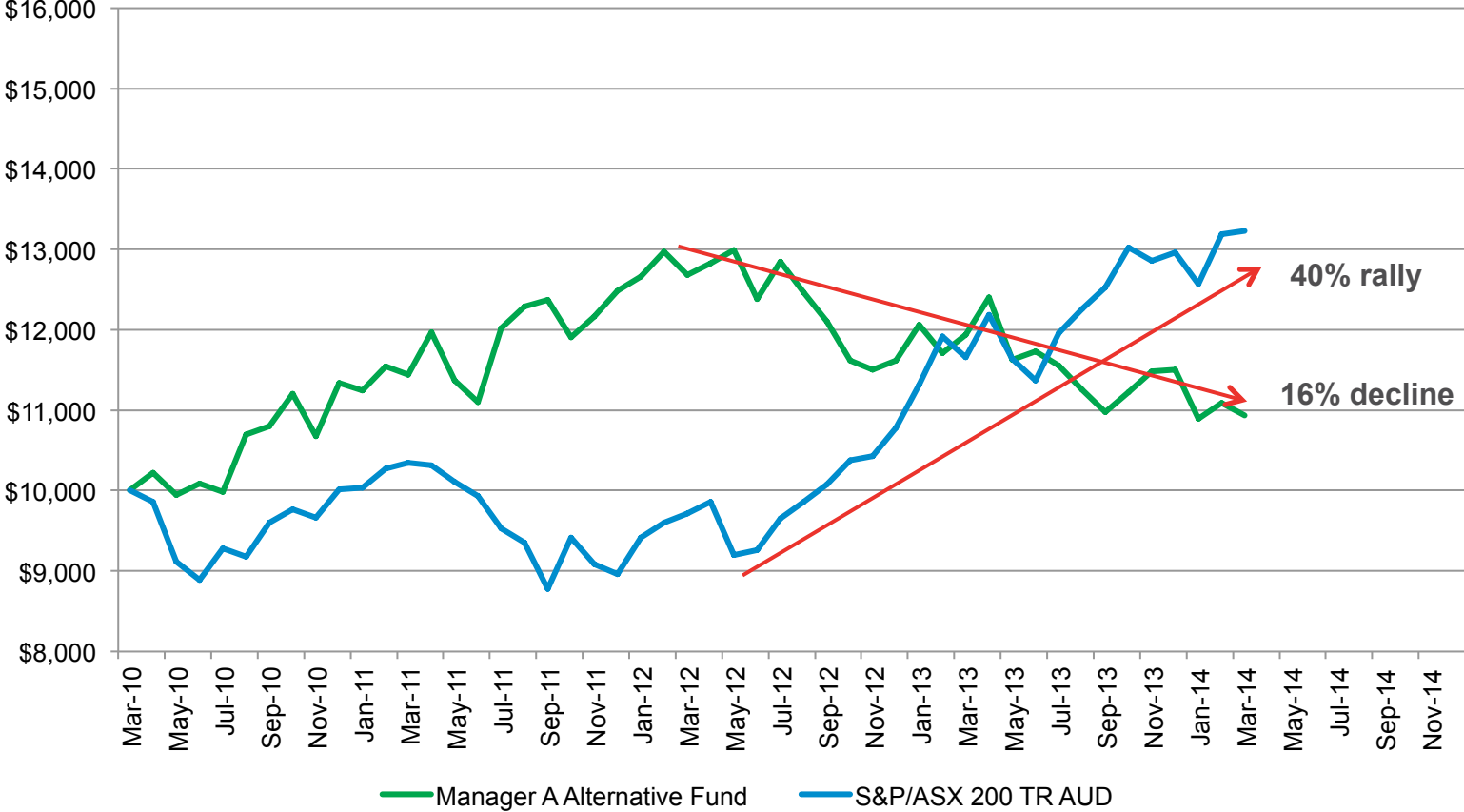
Source – Zenith CTA and Global Macro Sector Review and Multi-Strategy FOF Sector Review

Correlations of CTA Strategies

Correlation May 2011 to Dec 2014				
	Winton Global Alpha	Aspect Diversified Futures	AQR Wholesale Managed Futures	Man AHL Alpha (AUD)
Winton Global Alpha	1.00			
Aspect Diversified Futures	0.82	1.00		
AQR Wholesale Managed Futures	0.66	0.72	1.00	
Man AHL Alpha (AUD)	0.71	0.79	0.65	1.00
Average Correlation	0.73			

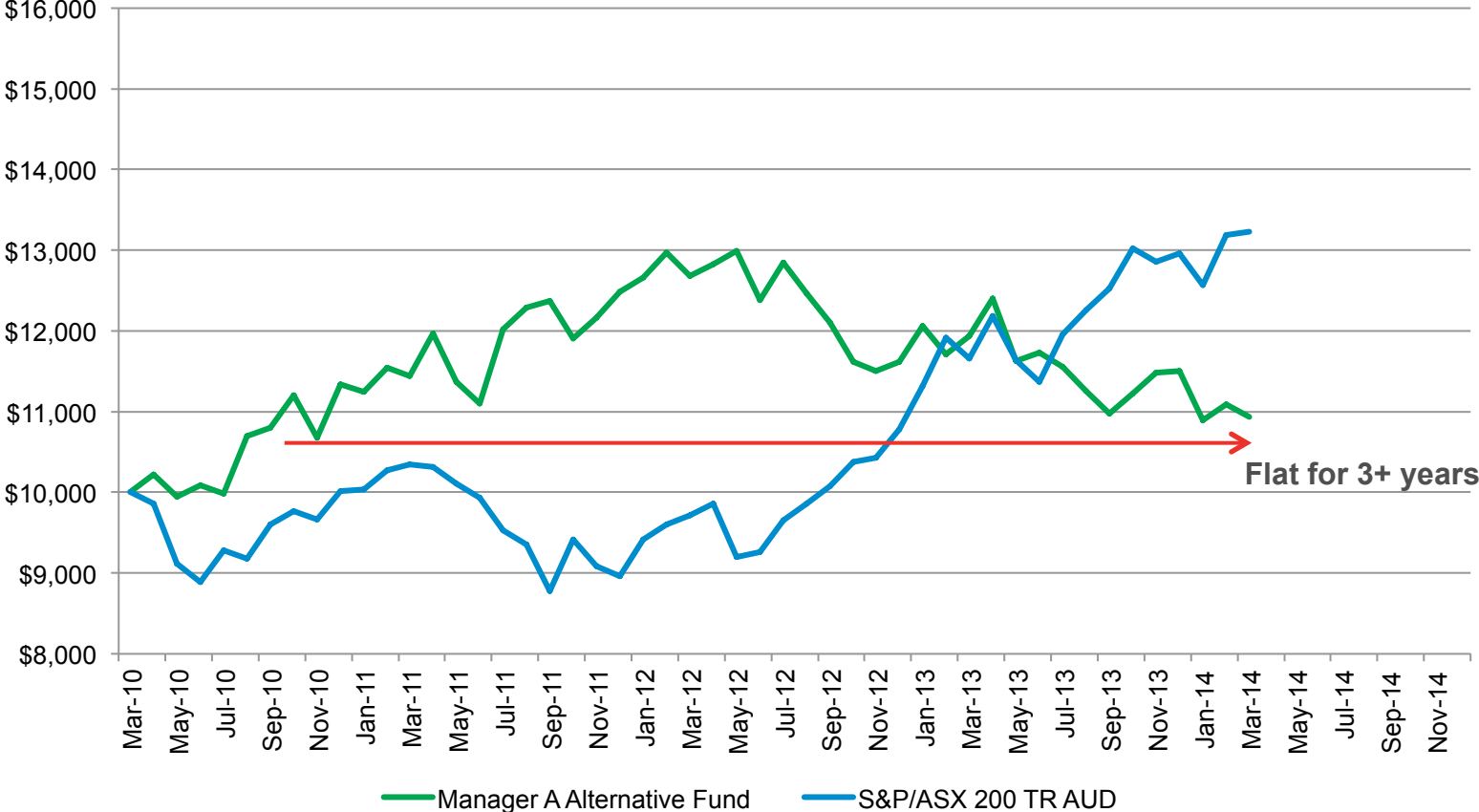
Source – Zenith and BlackRock

Behavioural Perspectives



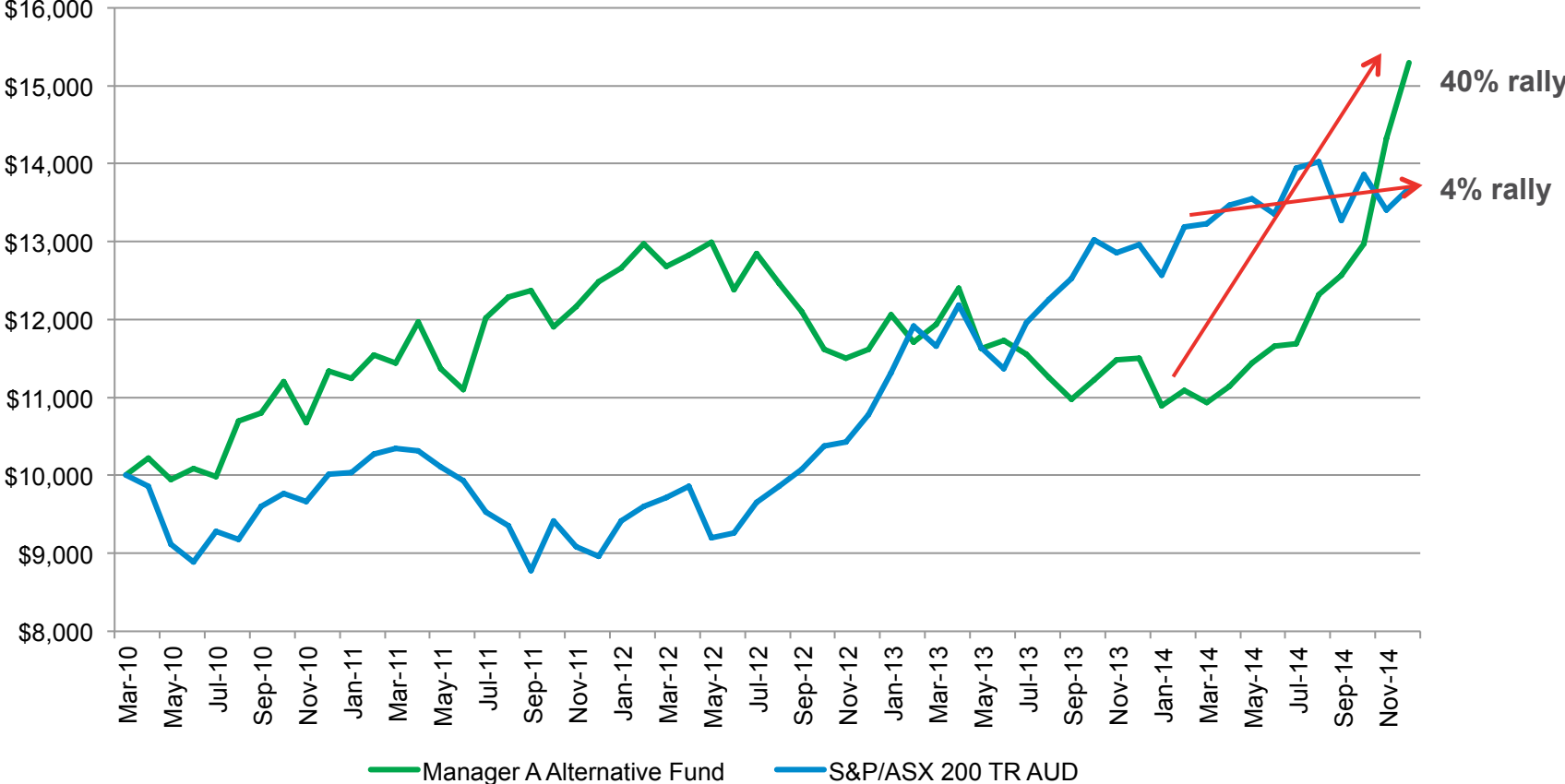
Past performance is not a reliable indicator of future performance. Long-term performance returns show the potential volatility of returns over time.
 Source: MPI Stylus, Morningstar

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The One Rule to Rule Them All

The first rule of investing – Diversify, Diversify, Diversify!

Most Alternative Portfolios aren't properly diversified.

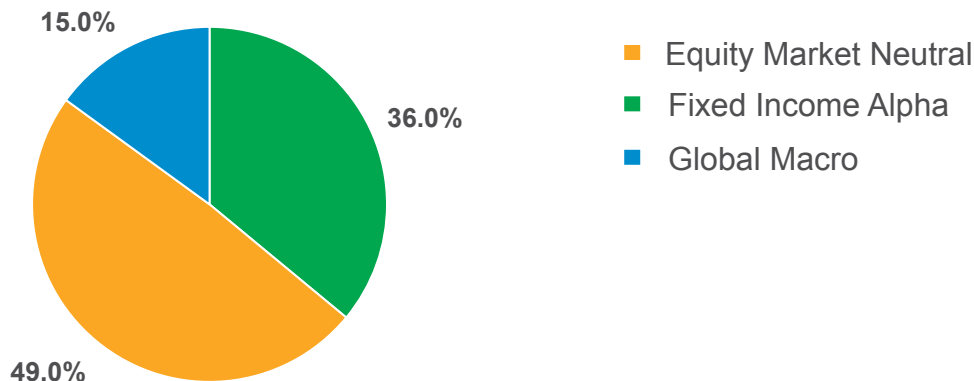
- ▶ Small capital allocation (10 - 15%) to allocate from
- ▶ A lack of liquid opportunities
- ▶ Platform availability
- ▶ Capital allocation Vs Risk allocation
- ▶ Lack of research ability

We allocate to Alternatives to diversify our portfolios, but then we fail to diversify our Alternative Portfolios.

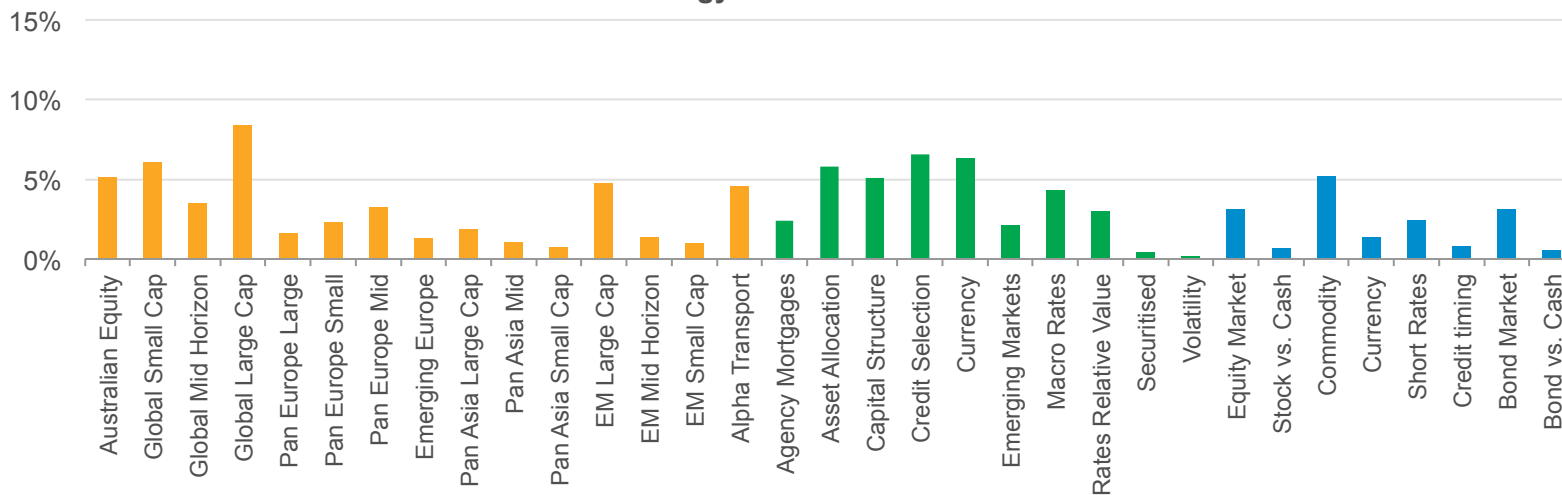
An allocation to a Multi-Strategy Fund or a Fund of Funds can help diversify your alternatives portfolio.

Extracting alpha from a broad array of asset markets & strategies

Current Risk Allocation*

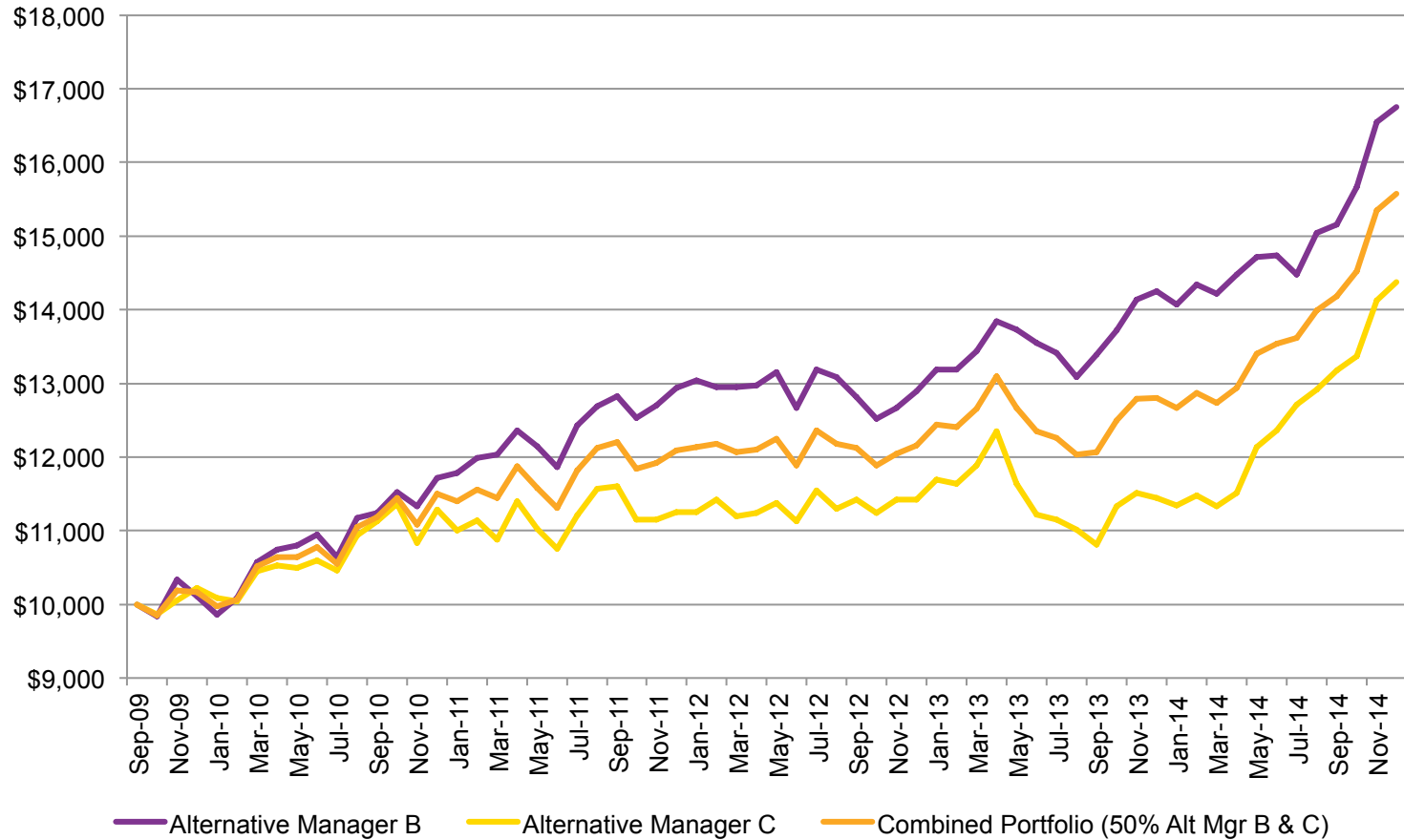


Strategy Diversification*



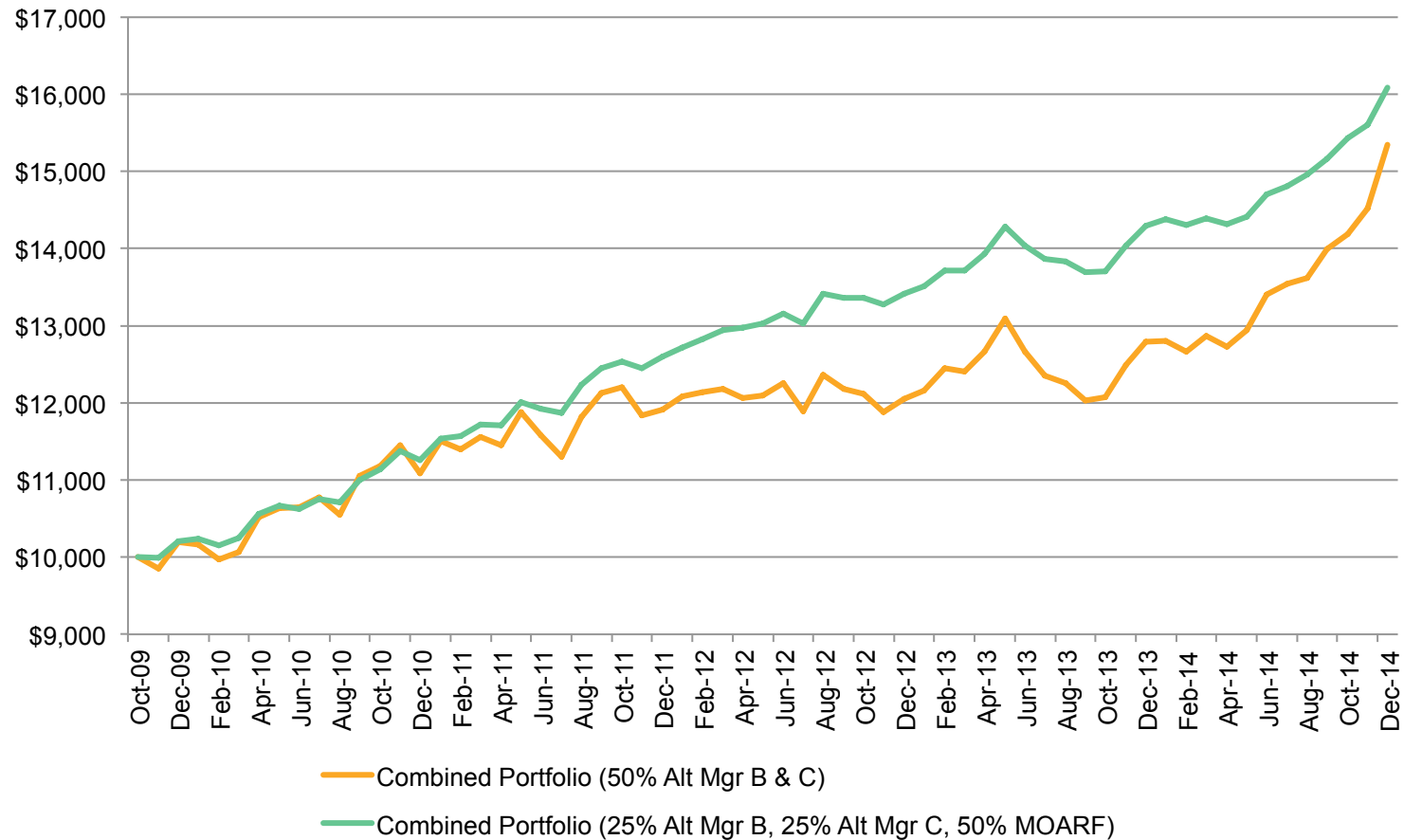
As at 31 March 2015
Source: BlackRock

A more consistent result?



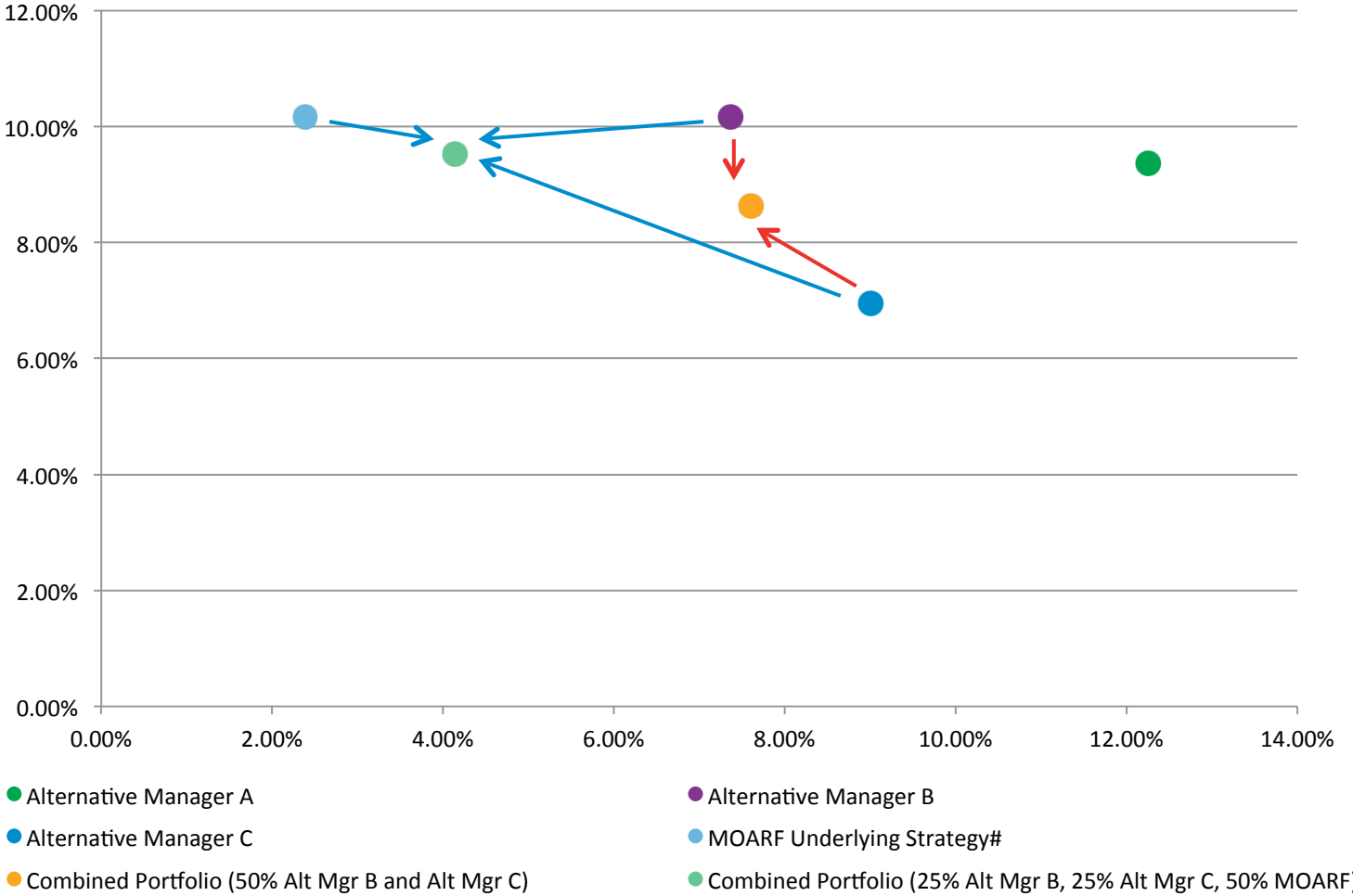
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Source: MPI Stylus, Morningstar

A much more consistent result



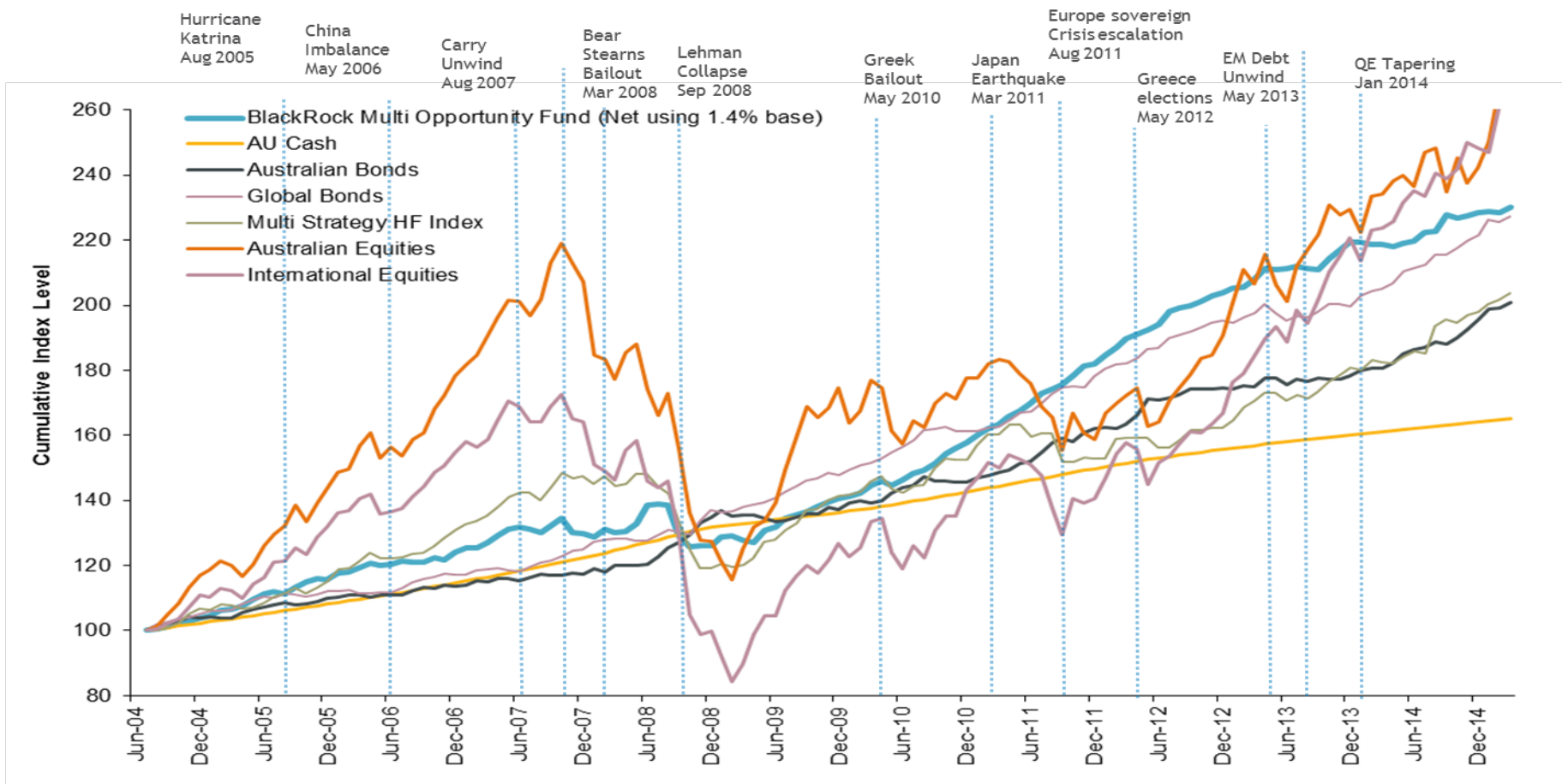
Past performance is not a reliable indicator of future performance. Long-term performance returns show the potential volatility of returns over time.
Source: MPI Stylus, Morningstar

De-Risking your Alternatives Portfolio



Past performance is not a reliable indicator of future performance. Long-term performance returns show the potential volatility of returns over time.
 Source: MPI Stylus, Morningstar

BlackRock Multi Opportunity Fund



*Chart shows cumulative returns since July 2004 to 31 March 2015. Source: Datastream, BlackRock. Past performance is not a reliable indicator of future results. Refer to Important Information.

The BlackRock Multi Opportunity Absolute Return Fund (“MOARF”) invests in, and has the same underlying investment strategy as, the BlackRock Multi Opportunity Fund (“Underlying Strategy”). Past performance in this presentation is for the “Underlying Strategy”, which has an inception date of 31 July 2004 and is only available to wholesale clients. MOARF has an inception date of 31 July 2013.

Past performance information in this presentation for the Underlying Strategy is estimated and unaudited, for a representative investment of \$100,000 in the Underlying Strategy from inception subject to a 1.40% (annualised) management fee and a 20% performance fee which are fees attributable to MOARF.

Net performance of MOARF and the Underlying Strategy will vary due to fee differences and different inception dates.

Summary

A typical client portfolio is heavily dependant on Economic Factors to generate returns

Alternatives are an important means of portfolio diversification, but

Diversifying your alternatives portfolio hasn't always been easy.

A Multi-Strategy Hedge Fund can help with diversification.

The BlackRock Multi-Opportunity Absolute Return Fund can help de-risk and diversify your alternatives portfolio.

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